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Supreme Court of the United States

OCTOBER TERM, 1934.

No. 338.

DAVID H. JENNINGS, Receiver of the National Bank of America, and National Bank of America, *Petitioners,*

vs.

UNITED STATES FIDELITY AND GUARANTY COMPANY, *Respondent.*

BRIEF OF PETITIONERS.

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(A) Where, as in the instant case, and in the companion cases Nos. 340 and 374, set for argument immediately after this case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust he must affirmatively establish, under the unmistakable trend and weight of Federal decisions: (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank. No tracing is possible when a check held for collection is used by the collecting bank in payment of its debts.

In the instant case the collection bank never received an identifiable res, an essential to the creation of a trust. Its assets were not augmented because collection was effected through a clearings transaction on a day

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when the balance of clearings was against the collecting bank which debit balance it paid with its Chicago draft and received nothing in the clearings except checks drawn on itself. These checks, when later charged against the drawer's accounts, resulted in mere book-keeping transfers, defeating all possibility of proof of either augmentation or tracing of funds 6

(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing appear, the dignity of the claim is in no way increased, nor was it intended to be increased, by the provisions of Sections 1, 2, 9, and 10 of the Indiana Bank Collection Code 15

(C) The jurisdiction of the District Court is limited to the determination of the validity of the trust claim asserted, and to a direction to the Receiver to certify the claim to the Comptroller of the Currency for payment in due course of administration. The court below should have reversed the District Court's order to the Receiver to pay forthwith; should have dissolved the permanent injunction issued by the District Court restraining the Receiver from disposing of the bank's assets as required by the National Bank Act, and should have allowed a general claim.... 32

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vs.

UNITED STATES FIDELITY AND GUARANTY COMPANY, *Respondent.*

BRIEF OF PETITIONERS.

I.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Seventh Circuit (Sparks, Circuit Judge) is reported in 71 Fed. (2) 618 and appears in the record at pages 46 to 54. The opinion of the United States District Court, Northern District of Indiana (Slick, D. J.) is reported in 4 Fed. Supp. 569 and appears in the record at pages 27 to 30.

II.

JURISDICTION.

Writ of certiorari was granted on October 8, 1934 (R. 62) under Section 240 (a) of the Judicial Code as amended by the act of February 13, 1925 (U. S. C. Title 28, Section 347)

III.

STATEMENT OF THE CASE.

This is an action, removed from the Lake County Circuit Court of the State of Indiana to the United States District Court for the Northern District of Indiana, (R. 1) wherein the plaintiff, the United States Fidelity & Guaranty Company (respondent here) sued the Receiver of the National Bank of America, Gary, Indiana (petitioner here) to impress a trust upon the assets of the bank that passed to the Receiver. The case was heard upon complaint (R. 2), answer (R. 11), and stipulation of facts (R. 16) resulting in a decree for the plaintiff (R. 30), which was affirmed by the Circuit Court of Appeals for the Seventh Circuit (R. 46 to 54), except that the trial court's allowance of interest, after the bank's suspension, was reversed (R. 54). Petition for writ of certiorari, filed by the bank Receiver was granted October 8, 1934.

The National Bank of America was placed in the hands of an agent of the Comptroller of the Currency for liquidation as an insolvent National bank, prior to the commencement of business, on January 4, 1932. On December 31, 1931, prior to its suspension, this National bank received, through the usual correspondent bank channels, as agent to collect and remit, a check in the amount of $2,196.89, owned by the respondent and drawn on the Gary State Bank of Gary, Indiana (R. 21). On this date the Gary Clearing House Association operated in Gary, the National Bank of America, the First National Bank of Gary (R. 22) and the Gary State Bank being the only members thereof (R. 22). On December 31, 1931, the National Bank of America delivered to the Clearing House checks totaling $10,425.45, including the item of $2,196.89 involved in this action, drawn on other banks, and *received in return checks drawn on the National Bank of America,* totaling $11,470.19 (R. 22, 23). Thereupon the National Bank of America paid its debit clearings balance in the amount of $1,044.75 with

a Chicago draft in accordance with the practice (R. 23). This draft was paid and is not involved in the present suit. In attempted remittance for the respondent's item of $2,196.89, plus other items received from the same correspondent bank, and in accordance with the usual practice, the National Bank of America sent the correspondent bank, located in Indianapolis, its Chicago draft in the amount of $3,660.83, drawn against a sufficient balance, which draft failed of payment because the Chicago bank received notice of the drawer bank's suspension before presentation (R. 24, 25).

In answering the action of the United States Fidelity & Guaranty Company to establish a trust against the bank's assets the bank Receiver admitted that the National bank was agent to collect and remit and that the sum of $2,196.89 was due the plaintiff as a general claim only but denied the trust fund contention on the ground that the assets and funds of the National bank were not augmented or increased by the aforesaid collection through the Clearing House in view of the fact that the clearings resulted in the debit balance against the National bank (R. 22, 23). The District Court held that the cash items of the National bank became impressed with a trust in the plaintiff's favor in the sum of $2,196.89 as a result of the collection of the item in the manner stated and that the Receiver took over this sum of money, subject to the trust (R. 26). The District Court directed the bank Receiver to pay the plaintiff the sum of $2,429.32 (which included interest) forthwith and permanently enjoined him from using so much of the bank's cash and cash items in his hands as might be necessary to satisfy the decree. The Circuit Court of Appeals held that as a result of the collection through the clearing house in the manner stated, a trust in the plaintiff's favor, in the sum of $2,196.89 attached to the cash and cash items of the collecting National bank (R. 51, 52); that the assets of the collecting bank were augmented; that the proceeds are traceable into the hands of the Receiver (R. 54) and

that the dignity of the plaintiff's claim against the National bank was increased by certain provisions of the Indiana Bank Collection Code, particularly Section 9 thereof. The Circuit Court of Appeals reversed the District Court's allowance of interest.

IV.

SPECIFICATION OF ERRORS.

(a) The Circuit Court of Appeals erred in holding that the relationship of principal and agent, admittedly existing between the respondent and the collecting National bank, ever became that of trustee and cestui que trust.

(b) The Circuit Court of Appeals erred in holding that the collection transaction augmented the assets of the collecting National bank.

(c) The Circuit Court of Appeals erred in holding that the proceeds of the collection transaction are traceable into the hands of the bank Receiver.

(d) The Circuit Court of Appeals erred in not holding that the respondent's claim against the bank Receiver is a general claim only.

(e) The Circuit Court of Appeals erred in holding that the dignity of the respondent's claim against the bank Receiver was increased in any manner by the provisions of Sections 1, 2, 9, and 10 of the Indiana Bank Collection Code.

(f) The Circuit Court of Appeals erred in not reversing the District Court's direction to the bank Receiver to pay the plaintiff forthwith the sum of $2,429.32 or any other sum except on the basis of allowance of a general claim and payment of pro rata dividends thereon.

(g) The Circuit Court of Appeals erred in not dissolving the permanent injunction issued by the District Court restraining the bank Receiver from using so much of the bank's cash and cash items in his possession as is needed to satisfy the decree.

V.

SUMMARY OF ARGUMENT.

(A) Where, as in the instant case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust he must affirmatively establish, under the unmistakable trend and weight of Federal decisions: (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank. No tracing is possible when a check held for collection is used by the collecting bank in payment of its debts.

In the instant case the collecting bank never received an identifiable res, an essential to the creation of a trust. Its assets were not augmented because collection was effected through a clearings transaction on a day when the balance of clearings was against the collecting bank which debit balance it paid with its Chicago draft and received nothing in the clearings except checks drawn on itself. These checks, when later charged against the drawer's accounts, resulted in mere bookkeeping transfers, defeating all possibility of proof of either augmentation or tracing of funds.

(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing appear, the dignity of the claim is in no way increased, nor was it intended to be increased, by the provisions of Sections 1, 2, 9, and 10 of the Indiana Bank Collection Code.

(C) The jurisdiction of the District Court is limited to the determination of the validity of the trust claim asserted,

and to a direction to the Receiver to certify the claim to the Comptroller of the Currency for payment in due course of administration. The court below should have reversed the District Court's order to the Receiver to pay forthwith; should have dissolved the permanent injunction issued by the District Court restraining the Receiver from disposing of the bank's assets as required by the National Bank Act and should have allowed a general claim.

VI.

ARGUMENT.

(A) Where, as in the instant case, and in the companion cases Nos. 340 and 374, set for argument immediately after this case, a claimant seeks to recover from a Receiver of an insolvent National bank money alleged to have been held by the bank on a trust, he must affirmatively establish, under the unmistakable trend and weight of Federal decisions: (1) that his transaction with the bank has resulted in a trust relationship; (2) that the assets of the bank have been augmented or increased by new cash or property accruing from the claimant; (3) that the new property, in its original or changed form, can be traced to the assets taken over by the Receiver at suspension. No augmentation occurs, hence no tracing exists where the transaction results only in a shifting of bookkeeping credits on the books of the now insolvent National bank. No tracing is possible when a check held for collection is used by the collecting bank in payment of its debts.

In the instant case the collecting bank never received an identifiable res, an essential to the creation of a trust. Its assets were not augmented because collection was effected through a clearings transaction on a day when the balance of clearings was against the collecting bank which debit balance it paid with its Chicago draft and received nothing in the clearings except checks drawn on itself. These checks, when later charged against the drawer's accounts, resulted

in mere bookkeeping transfers, defeating all possibility of proof of either augmentation or tracing of funds.

The mandate of the National Bank Act requires a pro rata distribution of the assets of an insolvent National bank among all creditors. This mandate can be avoided by the respondent only upon affirmative proof of trust relationship, augmentation, and tracing of funds to the Receiver.

Section 5236 U. S. R. S. (12 U. S. C. Ch. 2, Sec. 194) (Appendix p. 40) requires a pro rata distribution of an insolvent National bank's assets among all its creditors. In referring to this section this court said in Cook County National Bank v. United States, 107 U. S. 445, 450, that it

> "*provides for the distribution of the entire assets of the bank,* giving no preference to any claim except for moneys to reimburse the United States for advances in redeeming the notes. When this reimbursement is fully provided for, the balance of the assets, as the proceeds are received, is subject to a ratable dividend on all claims proved to the satisfaction of the receiver, or adjudicated by a court of competent jurisdiction."

Even the United States as a sovereign is a general creditor only, unless it has taken the security provided by law, except for advances to redeem the circulating notes and in minor instances involving certified checks given for customs duties and certain taxes. (19 U. S. C. Ch. 3, sec. 198; 26 U. S. C. Ch. 3, sec. 109). The circulating notes are required to be adequately secured at all times and the debtor continues to be primarily liable for the taxes and duties and consequently the exceptions are very rarely applicable.

The respondent can avoid participation in the pro rata distribution provided by the National Bank Act only upon a showing that the assets that passed into the hands of the Receiver for the benefit of all creditors included the identifiable property of the claimant or its proceeds. The re-

spondent must show, *by the burden of proof*, that as a result of its transaction the bank, before suspension, (a) received property of the claimant in trust, (b) that the property so received actually augmented the existing assets of the bank by way of adding thereto cash or other property (as distinguished from the addition of a bookkeeping credit) and (c) that the augmented assets, in their original or changed form passed into the hands of the Receiver.

Unless the record contains affirmative proof by the respondent of trust relationship, augmentation and tracing of funds to the Receiver the trust claim fails because all doubts must be resolved in favor of the bank Receiver who is the trustee for general creditors. As stated by this court in Texas & Pacific Railway v. Pottorff, 291 U. S. 245, 261, Note 19, decided at the last term:

> "The claimant has the burden of identifying the property in its original or altered form. Schuyler v. Littlefield, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged. Wuerpel v. Trust Co., 238 Fed. 269, 272-3; Knauth v. Knight, 255 Fed. 677; State Bank of Winfield v. Alva Security Bank, 232 Fed. 847; In re See, 209 Fed. 172; In re Dorr, 196 Fed. 292; City Bank v. Blackmore, 75 Fed. 771; compare Railway v. Spiller, 274 U. S. 304, 311; Cunningham v. Brown, 265 U. S. 1."

In its opinion in Schuyler v. Littlefield, 232 U. S. 707, this court said, at page 713:

> "All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically asserting title to $9600 said to have been traced into stock in the possession of the Trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as represent-

ing the proceeds of their Interborough stock their claim must fail. If their evidence left the matter of identification in doubt the doubt must be resolved in favor of the trustee, who represents all of the creditors of Brown & Co., some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

For a summarized statement of the principles of law applicable to these claims in a case wherein the facts are substantially the same as those presented in the instant case, the following excerpt is quoted from the opinion of the Circuit Court of Appeals for the Eighth Circuit in Farmers National Bank v. Pribble, 15 Fed. (2nd) 175-176:

"It is clear that counsel for the plaintiff were familiar with and probably had before them when they drew this complaint the established rule in the federal courts prescribing the facts requisite to establish a cause of action by a *cestui que trust* to recover from the receiver of the property of an insolvent corporation the payment in full of a trust fund in his possession in preference to the payment of anything to its general creditors, for they pleaded and set forth such facts in the complaint as stated a perfect cause of action in accordance with that rule, which is:

" 'It is indispensable to the maintenance by a *cestui que trust* of a claim to preferential payment (by a receiver) out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and then the claim can be sustained to that fund or property only, and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and value thereof which came to the hands of the receiver.' Empire State Surety Co. v. Carroll County, 194 F. 593, 114 C. C. A. 435; and cases there cited; Beard v. Independent School District, 88 F. 375, 31 C. C. A. 562; In re Seven Corners

Bank, 58 Minn. 5, 59 N. W. 633; American Can Co. v. Williams (C. C.), 176 F. 816; Willoughby v. Weinberger, 15 Okl. 226, 79 P. 777; Macy v. Roedenbeck, 227 F. 347, 356; 142 C. C. A. 42, L. R. A. 1916 C, 12; Central Trust Co. v. Chicago, A. & N. Ry. Co. (D. C.), 232 F. 936, 943; State Bank of Winfield v. Alva Security Bank, 232 F. 847, 849, 147 C. C. A. 41; Titlow v. McCormick, 236 F. 209, 149 C. C. A. 399; Zenor v. McFarlin, 238 F. 721, 725, 151 C. C. A. 571; Scullin Steel Co. v. North American Co., 255 F. 945, 947, 167 C. C. A. 237; Mechanics & Metals Nat. Bank v. Buchanan (C. C. A.), 12 F. (2d) 891.

The doctrine that a *cestui que trust,* whose property had helped to swell the general assets of a corporation which was or became insolvent, has a prior right or interest in those general assets, without specific identification and tracing of such claimant's property, was again expressly repudiated by this court in the case last cited. *The fact that the claimant's property paid or reduced the indebtedness or liability of the insolvent corporation, so that it will pay a larger percentage of its debts, justifies no lien on its assets by or preference in payment to the cestui que trust* (1) because such a reduction of indebtedness does not increase the property or the value of the property of the insolvent; and (2) because the property of the claimant so used to pay a part of the insolvent's general indebtedness or liability never goes into, and therefore cannot be traced into, the property or assets of the insolvent which subsequently come into the possession of the receiver. Titlow v. McCormick, 236 F. 209, 149 (C. C. A.) 399; American Can Co. v. Williams (C. C.), 176 F. 816; Lucas County v. Jamison (C. C.), 170 F. 338; Multnomah v. Oregon National Bank (C. C.), 61 F. 912; Beard v. Independent School District, 88 F. 375, 31 C. C. A. 562; Hecker-Jones-Jewell Mill Co. v. Cosmopolitan Trust Co., 242 Mass. 181, 136 N. E. 333, 24 A. L. R. 1148. (Italics inserted)

The case of Schilling v. Rowe (C. C. A. 9), 64 Fed. (2nd) 188, 190, involved facts similar to those presented in the instant case, the collection having been effected through a clearing house transaction on a day when the balance in

the clearings was against the collecting bank. In classifying the claim as general only the court said in its opinion at page 190:

> "*The authorities are uniform* that where checks held by a bank in its trust capacity are used by the bank to pay indebtedness due from it to other banks on account of negotiable paper held by them through the ordinary process of clearings, or otherwise, that there is no augmentation of the assets which come into the hands of the receiver within the rule making the priority of the beneficiary depend upon such augmentation." (Italics inserted)

In Dickson v. First National Bank (C. C. A. 8), 26 Fed. (2nd) 411, two checks were collected through a clearings transaction on a day when the balance was against the collecting bank. In its opinion at page 412 the court said:

> "The ultimate result was that the indebtedness of the defendant bank was decreased to the amount of these two checks. The transaction did not in any sense result in increasing the assets of the bank which were available for distribution to creditors. *To grant plaintiff a preference would not be to authorize him to take from the assets something which rightfully belonged to him by reason of his property being wrongfully added to the assets, but it would permit him to take from the assets funds which belong to other creditors.*" (Italics inserted)

To the same effect under similar factual situations are:

Rorebeck v. Benedict Flour & Feed Co., (C. C. A.) 26 Fed. (2) 440, 441.
City Bank v. Blackmore, ~~76~~ 75 Fed. 771, 773.
Empire State Surety Co. v. Carroll County (C. C. A. 8), 194 Fed. 593, 603, 604, 606.
Spokane Co. v. First National Bank (C. C. A. 9), 68 Fed. 979, 982.
Nyssa-Arcadia Drainage Dist. v. First National Bank, 3 Fed. (2nd) 648.
American Can Co. v. Williams (C. C. A. 2), 178 Fed. 420, 422.

First National Bank v. Williams (D. C. N. C.), 15 Fed. (2) 585, 587. (Opinion by Circuit Judge Parker sitting as District Judge.)
Smith Reduction Corp. v. Williams (D. C. N. C.), 15 Fed. (2) 874. (Opinion by Circuit Judge Parker sitting as District Judge.)

In the instant case the respondent can establish a general claim only because the original relationship of principal and agent, admittedly existing between the parties, never became that of trustee and *cestui que trust*. The collecting bank received nothing as a result of the collection of the respondent's item through the Clearing House except checks drawn on itself. These checks, drawn against credit balances then on the books of the collecting National bank, when charged to the depositors' accounts, resulted in mere transfers of bookkeeping credits which did not create a res, an essential to a trust. A trust cannot exist unless there is a res, *i. e.*, property to which the trust pertains. (American Law Institute, Trusts Restatement, Section 70.) A debt owing by the collecting bank to either its depositors or the forwarder of the collection item cannot become a trust res because "An obligor cannot be trustee either of his duties or of the obligee's rights under the obligation." (American Law Institute, Trusts Restatement, Section 75, and comment "a" and illustration thereto.) As stated by this court in Blakey v. Brinson, 286 U. S. 254, 263, in discussing similar transfers of credit:

> "The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it."

In the instant case the respondent's collection item was dissipated through use by the collecting bank in a clearings transaction on a day when it had a debit balance. These facts defeat the trust, augmentation, and tracing of funds contentions but the respondent asserts (respondent's brief

in opposition to petition for certiorari, page 4) that the collecting bank received checks drawn on itself ($11,470.19, R. 23) in payment of the collection item. Even on this theory the collection proceeds consisted of checks drawn on the now insolvent National bank which, as already stated, could not be the subject of a trust. In a recent case in the Circuit Court of Appeals for the Eighth Circuit—Hirning v. Federal Reserve Bank, 52 Fed. (2nd) 382, 386—the Court, in discussing these principles, said:

> "It is contended by the appellee that the checks sent by the Reserve Bank to the Brookings Bank constituted a trust fund, and that this trust fund has been traced into the currency and collection items sent by the Brookings Bank to the Reserve Bank.
>
> "The trial court seems to have adopted this view as one of the grounds of its decision in ordering judgment for defendant.
>
> "We do not agree with this contention. It must be remembered that the checks sent to the Brookings Bank by the Reserve Bank were all of them checks drawn on the Brookings Bank. *When the Brookings Bank accepted the checks, this produced no additional funds in its hands. Its assets were not augmented. No trust fund was created. If there was no trust fund, there could, of course, be no tracing of the trust fund into any assets of the Brookings Bank.* The doctrine that a trust fund is created when checks drawn on bank A by bank B for collection, *i. e.*, for payment, has been disapproved by the decisions in this Circuit, *as has also the doctrine that the forwarding bank or its principal has a general lien on the assets of the drawee bank* for the payment of such checks. Rorebeck v. Benedict, etc. Co., 26 Fed. (2nd) 440; Farmers National Bank v. Pribble, 15 Fed. (2nd) 175; Larabee Flour Mills v. First Nat. Bank, 13 Fed. (2nd) 330; Macy v. Roedenbeck, 227 Fed. 346, 352; Beard v. Independent Dist., 88 Fed. 375." (Italics inserted)

To the same effect are the following excerpts from opinions of the Circuit Courts of Appeal for the Fourth and Fifth Circuits:

Anheuser-Busch Brewing Ass'n v. Clayton, (C. C. A. 5), 56 Fed. 759-60:

"The relation between appellant and the McNab Bank as to the draft on Morris sent by the former to the latter for collection was that of principal and agent; but, in order to enforce a trust in favor of appellant as to any money collected on said draft, it must be specifically traceable into the hands of the receiver. Commercial Nat. Bank v. Armstrong, 39 Fed. Rep. 684; same case in Supreme Court of the United States (Oct. term, 1892; not yet officially reported, 13 Sup. Ct. Rep. 533). *Accepting Morris' check in payment of his debt to appellant, and charging the amount of it on Morris' account by the bank, was but a shifting of its liability, whereby it became appellant's debtor,* and assumed the obligation to pay to it the amount of the check less exchange. There is nothing to indicate that this amount was separated and kept unmingled with the bank's own money; but, on the contrary, it is conceded that it is undistinguishable from the mass of the bank's own money, and cannot be traced to and identified in the hands of the receiver. This being so, appellant has no better equity than the other creditors of the bank, and is entitled to no priority over them. It can only come in as a general creditor, * * *" (Italics inserted)

Ellerbe v. Studebaker Corp. (C. C. A. 4), 21 Fed. (2nd) 993:

"In ordinary cases, of course, the receipt by the collecting bank of a check drawn against the account of one of its depositors does not bring anything into the bank, and cannot be said to augment in any way assets passing into the hands of the Receiver. It is a mere shifting of credits. Larabee Mills v. First Nat. Bank (C. C. A. 8th), 13 Fed. (2nd) 330; American Can Co. v. Williams (C. C. A. 2), 178 Fed. 420; North Carolina Corp. Com. v. Merchants & Farmers Bank, 137 N. C. 697, 50 S. E. 308."

A claim for a trust status against the assets of an insolvent National bank, based upon a transfer of bookkeeping credits was classified as general only by the Circuit

Court of Appeals for the Fifth Circuit in its recent decision in First National Bank of St. Petersburg v. City of Miami, 69 Fed. (2nd) 346, a case that was twice certified to this court and argued on one occasion, the certificates being dismissed on jurisdictional grounds. The court said in its opinion (p. 347):

> "As proven, no sum whatever was collected and held for plaintiff by the St. Petersburg bank to which a trust could attach. In this state of the proof to hold the bank as trustee would be to hold it a trustee not of a thing, but of a claim against itself, a holding on its face so artificial and unreal as to be impossible."

The bank Receiver submits that in this case, as in Blakey v. Brinson, 286 U. S. 254, the claim should be classified as general only because of the failure to establish a relationship of trustee and cestui que trust.

(B) Where, as in the instant case, the record facts establish that neither trust relationship, augmentation, nor tracing appear, the dignity of the claim is in no way increased, nor was it intended to be increased, by the provisions of Sections 1, 2, 9, and 10 of the Indiana Bank Collection Code.

Sections 1, 2, 9 and 10 of the Indiana Bank Collection Code were not intended to and do not alter or modify the Federal rule stated under "A" above.

In its opinion the court below recognizes the Federal rule discussed under "A" above, which classifies the respondent's claim as general only, but undertakes to avoid it in the instant case by a finding (R 48) that:

> "Whether a trust relationship existed between the bank and appellee, by virtue of the circumstances hereinbefore set forth, is to be determined by sections 1, 2, 9, and 10 of the Indiana Uniform Bank Collection Code, ch. 164, Indiana Acts, 1929."

It has always been the position of the Comptroller of the Currency and it is the position of the bank Receiver in this case that all of the provisions of the Bank Collection Code, adopted in 18 States, are applicable to the transactions of National banks doing business in those States, except Section 13 of this Code, and, as more fully hereinafter indicated, it is believed Section 13 is inapplicable to insolvent National banks because it is in conflict with the pro rata distribution mandate of Congress (Sec. 194, Title 12 U. S. C.) (Appendix p. 40) and with the decisions of this court in Davis v. Elmira Savings Bank, 161 U. S. 275, 283, 284, 286; Easton v. Iowa, 188 U. S. 220, 229; and Cook County National Bank v. United States, 107 U. S. 445. "But a National bank is subject to State law unless that law interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with some paramount Federal law." Lewis v. Fidelity Company, 292 U. S. 559, 566. For convenience of reference the complete Bank Collection Code is printed in the appendix (pages 41 to 58), together with a foreword and comment, section by section, by its proponents. A full discussion of this code, section by section, is contained in a series of articles by Wayne L. Townsend, Professor of Law, Western Reserve University, in the Tulane Law Review, Volume VIII, Nos. 1, 2, and 3, Dec. 1933, Feb. 1934, April 1934.

Petitioner contends, however, that nothing contained in Sections 1, 2, 9 and 10 of the Bank Collection Code lends support to the conclusion of the court below that the Legislature intended to impress a trust, in favor of the collection item forwarder, upon the cash and cash items of the collecting bank. The only sections of the Code intended to give the collection item *forwarder* protection against the contingency of insolvency are Sections 11, 12 and 13 and the only section intended to impress a trust upon the assets of the collecting bank in favor of the collection item forwarder is Section 13. Section 13 is designated by its framers (Appendix p. 49) "Insolvency and Preferences."

Subdivision 1 of Section 13 becomes effective "When the drawee or payor or any other agent collecting bank shall fail or be closed for business." Subdivision 2 of Section 13 becomes effective when the "drawee or payor shall fail or close for business as above." Subdivision 3 of Section 13 becomes effective "Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above."

Under the plain language of the Section the trust provided therein does not come into being except in the event of insolvency. Accordingly the section is void as to National banks under the following excerpt from the opinion of this court in Davis v. Elmira Savings Bank, 161 U. S. 275, 283:

> "It is clear that these two statutes cover exactly the same subject matter. Both relate to insolvent banks; both ordain that the right of preference on the one side and the duty of ratable distribution on the other shall only result from insolvency; both cover the assets of such banks coming, after insolvency, into the hands of the officer or person authorized to administer them. It is equally certain that both statutes relate to the same duty on the part of the officer of the insolvent bank; the one directs the representative to make a ratable distribution; the other requires, if necessary, the application of the entire assets to payment in full, by preference and priority over all others of a particular and selected class of creditors therein named. We have, therefore, on the one hand, the statute of the United States, directing that the assets of an insolvent national bank shall be distributed by the Comptroller of the Currency in the manner therein pointed out, that is, ratably among the creditors. We have on the other hand, the statute of the State of New York giving a contrary command. To hold that the State statute is operative is to decide that it overrides the plain text of the Act of Congress. This results, not only from the fact that the two statutes, as we have said, cover the same subject-matter, and relate to the same duty, but also because there is an absolute repugnancy between

their provisions, that is, between the ratable distribution, commanded by Congress, and the preferential distribution directed by the law of the State of New York.

The Circuit Court of Appeals for the Second Circuit held Section 13 of the Bank Collection Code inapplicable to insolvent National banks, in its recent decision in Old Company's Lehigh, Inc. v. Meeker, Receiver of the First National Bank of Mamaroneck, 71 Fed. (2nd) 280. This case is now pending in this court on the merits (No. 340) and the bank Receiver's brief therein (P. 2.1.) lists additional cases for the proposition that Section 13 of the Code is inapplicable to National banks.

The respondent in the instant case concedes (p. 3, Respondent's brief in opposition to petition for certiorari) that it does not rely on Section 13 of the Code. The court below did not rely on Section 13 to establish a trust. The bank Receiver admits that the relationship of principal and agent between the parties continued at all times until the bank's suspension. Consequently, the principal question before this court is whether or not the dignity of the respondent's claim is increased by Section 9 of the Code, (Sec. 3861.9 Vol. IV Burns' Ann. Ind. Stat., 1929 Supp.) which reads as follows:

> "Where ordinary care is exercised, any agent collecting bank may receive in payment of an item without becoming responsible as debtor therefor, whether presented by mail, through the clearing house or over the counter of the drawee or payor, in lieu of money, either (a) the check or draft of the drawee or payor upon another bank or (b) the check or draft of any other bank upon any bank other than the drawee or payor of the item or (c) such method of settlement as may be customary in a local clearing house or between clearing banks or otherwise; provided that whenever such agent collecting bank shall request or accept in payment an unconditional credit which has been given to it on the books of the drawee or payor or on the books of any other bank, such agent collecting bank

shall become debtor for such item and shall be responsible therefor as if the proceeds were actually received by it in money."

The views of the court below concerning the effect of Section 9 of the Bank Collection Code summarize the issues now before this court, and hence are quoted from its opinion (R. 51, 52):

> "Appellee argues that when appellant bank exchanged appellee's check on the Gary State Bank for checks which the latter held against the former at the clearing house transaction, appellee's check, by virtue of section 9 of the Indiana Act, was not used to pay the appellant's debt to the clearing house, but it was a collection of the check in a manner authorized by the Act; *hence that which it received is to be considered as proceeds of the check*, and since appellant bank did not request or accept an unconditional credit for the item on the books of the Gary State Bank, or of any other bank, as provided under section 9, the bank did not become responsible as debtor for either the check or its proceeds, but it still was liable as agent. *It further contends that the proceeds thus received in payment were the same as cash to appellant bank and were in contemplation of section 9 automatically reflected in the cash and cash items of that bank*, after the clearing house transaction, because the cash and cash items became instantly relieved from the obligations of the checks received in exchange to the extent of appellee's check, and that the legal effect of the transaction was a substitution of cash and cash items held by appellant bank to the extent of $2196.89 for checks upon itself which it received as agent in payment of appellee's check. Hence it says there was augmentation of the cash and cash items to the extent of the proceeds of appellee's check toward which appellant bank remained as fiduciary.
>
> "*We are in accord with appellee's contention in this respect.*" (Italics inserted)

Petitioner contends section 9 has no such purpose or effect. The language of Section 9 is exact and leaves no

room for construction. *Its purpose, in plainly expressed language, is to protect the collecting bank against a liability as debtor where it accepts something other than cash as the collection proceeds. The section protects the collecting bank and not the collection item owner.* The draft of the proponents of this legislation (App. 47) states the purpose of each section. Before Section 9 (App. 47) appears the statement "Medium of Payment". The intent of Section 9 is stated by the framers of the Act in the explanatory note (App. 56) to be:

> "The principle of Section 9 is to authorize the agent collecting bank to receive, instead of money, without being responsible therefor as debtor, the customary method of settlement for an item by draft on another bank or by exchange of items and settlement of balance by money or draft."

The purpose of section 9 is clearly understood when it is read in the light of this court's opinion in Federal Reserve Bank v. Malloy, (1924) 264 U. S. 160, which held that, in the absence of any instruction or permission from the owner of a check, or any custom brought to the notice of such owner, to the contrary, the bank has no authority to accept or receive in payment of a check indorsed to it for collection, anything other than money. This court held (page 167) that Regulation "J" of the Federal Reserve Board, 1920, "does not expressly permit the acceptance of payment other than in money." Thereafter, and in 1924, Regulation "J" of the Federal Reserve Board was amended to avoid the rule of the Malloy case and today, after subsequent amendments, reads in part, as follows:

> "The Federal Reserve Bank may, in its discretion and at its option, either directly or through or from an agent, accept in payment of or in remittance for such checks, cash, bank drafts, transfers of funds or bank credits, or other forms of payment or remittance, acceptable to the collecting Federal Reserve Bank. The Federal Reserve Bank shall not be liable for the fail-

> ure of the drawee bank or any agent to pay or remit for such checks, nor for any loss resulting from the acceptance from the drawee bank or any collecting agent, in lieu of cash, of any other form of payment of remittance authorized herein, nor for the nonpayment of, or failure to realize upon, any bank draft or other medium of payment or remittance which may be accepted from the drawee bank or any collecting agent."

This avoidance of the Malloy rule by the Federal Reserve Banks, the largest check collection agencies in the United States, resulted in a similar avoidance by practically all large banks through contracts with their customers. In this connection the following excerpt is quoted from Section 1451 a, Vol. 2, Paton's Digest (1926), (reference volumes found in most banks), edited and compiled by Thomas B. Paton, Jr., Assistant General Counsel of the American Bankers Association, who assisted in drafting the Uniform Bank Collection Code. (Appendix p. 41)

> "The Malloy decision, 264 U. S. 160, 68 L. ed. 617, 44 Sup. Ct. (1924) 296, 31 A. L. R. 1261 and note, confirms the need for a change in the passbook rules or other collection agreement to express authorization to the bank receiving checks on deposit for collection to accept the drawee's draft as payment in lieu of cash. A standard form of depositor's agreement is printed in 1446, which agreement was drafted to correct the undue burden assumed by a bank accepting collection items for deposit. *It was drafted since and in the light of the Malloy decision, and is recommended to all banks for their use.*" (Italics inserted)

Section 9 of the Bank Collection Code merely reduced to statutory form the protection collecting banks already enjoyed, and now enjoy in non-collection code States through contract, against becoming liable as debtor where something other than money was accepted as the collection proceeds. Nothing contained in the Section, or its history, gives support to the conclusion reached by the court below

that it was intended to attach a trust to the cash or cash items of the collecting bank in favor of the collection item owner. The section contemplates that collection will be effected in the usual course of the banking business and that the collecting bank will remit the proceeds by its credit instrument. The collection transaction involved in the instant case was handled exactly as contemplated by this section and the other sections of the Act. *The collecting National bank had no duty to segregate its assets in trust for the respondent, after collection was effected in the manner made, and it did not segregate assets to be held in trust for the respondent.* The section gives no suggestion that a lien on the collecting bank's assets was intended to result therefrom. As agent to collect, the collecting bank received nothing from the transaction except items drawn on itself. These items represented mere transfers of bookkeeping credits, which could not be the subject of a trust. Consequently a trust relationship never came into existence. As collecting agent the national bank, and now its Receiver, must account for what it received and this the Receiver has always been willing to do by allowing the respondent a general claim.

Even if the State Legislature had, (which we deny) by the use of plain language, affixed a lien to the collecting bank's assets prior to suspension, by the provisions of Sections 9 or 13 of the Bank Collection Code the result would be the same—a general claim only, for the reason that a National bank is without power to give security for a *private* deposit. Texas & Pacific Railroad v. Pottorff, 291 U. S. 245. An attempt to secure a *private* depositor or his assignee by lien or otherwise would be absolutely void. Under the respondent's theory in the instant case the collection proceeds consisted of checks drawn on the now insolvent National bank. When these checks were charged to the depositors' accounts private deposit balances were assigned. Hence *the legal position of the respondent is*

that of assignee of a private deposit balance. The State statute could give no power to a National bank, consequently it would be inapplicable to such a bank. The National Bank Act empowers National banks to give security for public deposits, consequently the respondent receives no assistance from this court's opinion in Lewis v. Fidelity & Deposit Company, 292 U. S. 559.

In Royal Manufacturing Company v. Spradlin, 6 Fed. Sup. 98, the District Court allowed a priority claim against an insolvent National bank on the lien theory, the North Carolina statute involved (Sec. 218(c) (14) N. C. Code 1927) being substantially different and much more favorable to the trust claimant's contentions than any provision of the Bank Collection Code. The proposition stated in this paragraph was there urged in the bank Receiver's brief on appeal. The Circuit Court of Appeals of the Fourth Circuit in reversing the District Court and classifying the claim as general only in its very recent and as yet unreported opinion dated November 19, 1934 (Parker, C. J.) (Appendix pp. 59-61) said:

> "It is clear, we think, that even if this proviso be construed as having relation to solvent banks as distinguished from those in liquidation, it cannot affect national banks. It has been held that these banks have no power to pledge their assets to secure a private deposit (Texas Pac. Ry. v. Pottorff, 291 U. S. 245, 253); and one of the reasons for this holding is that to permit such pledge would be inconsistent with many provisions of the National Bank Act which are designed to insure a ratable distribution of assets among creditors. *The same reasoning would forbid the creation of a lien on assets as security for funds collected. And, of course, if the creation of such a lien be beyond the powers of the bank, it could not be created by act of the state legislature; for the legislature could not provide that action on the part of the bank should give rise to a lien which the bank, by reason of the limitations imposed upon it by act of Congress, was powerless to create.*" (Italics inserted)

In the instant case as well as in the North Carolina case the trust claimant places much reliance on the opinion of this court in Lewis v. Fidelity and Deposit Company, *supra*. But, as Judge Parker states in his opinion in Royal Manufacturing Company v. Spradlin, *supra*:

> "*The case of Lewis v. Fidelity & Deposit Co., 292 U. S. 559, relied upon by appellee, is in reality an authority against its position.* In that case a statute of Georgia, creating a general lien on the assets of banks as security for deposits of state funds, was held to have application to a national bank merely because the act of Congress of June 25, 1930, c. 604, 46 Stat. 809, 12 U. S. C. A. 90, authorized a national bank to give security for a deposit of public funds of the same kind as authorized by state law for state banking institutions. *The Supreme Court said that no lien under the Georgia statute arose in 1928 when the deposit was made, and that the judgment of the court below sustaining the lien would have been reversed but for the enactment by Congress of the act of 1930. See p. 564. Here there is no act of Congress authorizing the creation of a lien on the assets of a national bank as security for collections; and the act of the North Carolina legislature can no more create a lien on the assets of a national bank than could the Georgia statute without the aid of the act of 1930.*" (Italics inserted)

In a number of cases trust claimants against insolvent banks have urged courts of equity to resort to fictions concerning segregation, but the Federal Courts have consistently declined to accept such suggestions even where the bank had a duty to segregate, which does not appear in the instant case. To quote from the summary of an article by Mr. Justice Stone entitled "Legal Problems in the Transmission of Funds", Columbia Law Review, June 1921, page 525:

> "The very essence of the right of priority over other creditors depends upon the setting apart of a particular fund for the benefit of the depositor. There is no

basis for giving one depositor a priority over another unless this is an essential part of the transaction. It is, of course, important that bankers should be held to a high standard of accountability to their customers. It would seem, however, that this should be accomplished by appropriate legislation which should inure to the benefit of depositors generally *rather than by the adoption of a rule of law creating special rights in favor of a limited class of customers on the theory that they are the beneficiaries of a quasi-trust fund which never in fact exists or is intended to exist as such.*" (Italics inserted)

On page 518 of the article Mr. Justice Stone says:

"The doctrine that money deposited with a bank for a special purpose is a fiduciary deposit, has been carried to extreme lengths in this country *in those cases where no specific money was ever paid to the bank, the customer merely giving or procuring a credit in account in favor of the bank* upon the banker's undertaking to effect payment at a distant point. Here there is no specific deposit. *The transaction results only in a credit appearing on the books of the bank, there being at no point of time any specific money or other res paid to or set apart or held by the bank for account of the customer. Even if there were an executory undertaking of the bank to become a fiduciary by setting apart such specific sum, such a relationship is not established until there is some actual setting apart or segregation of the money or some other res as the subject matter of the fiduciary relationship.*" (Italics inserted)

In the case of Schumacher v. Brinson, 52 Fed. (2nd) 821, the Circuit Court of Appeals for the Fourth Circuit resorted to a fiction but its decision allowing a trust claim was unanimously reversed by this court as Blakey v. Brinson, 286 U. S. 254, this court stating, pages 262, 263:

"The court below thought that the legal consequence to be attributed to the debiting of the account with the supposed purchase price of the bonds was the same as if the respondent had cashed a check for the amount

and had then proceeded to hand the money back to the bank under a specific agreement between him and the bank that the money was to be held as a special fund, for the sole purpose of completing the purchase. This view is not without support. (Citing authorities.) Such a procedure, *if actually carried out*, might afford a basis which is lacking here, for the inference that respondent, no longer content with the role of creditor, had sought to establish a trust fund. But *the mere debiting of his account, without more, for the reimbursement of the bank for the obligation which it was supposed to have incurred or paid, lends no support to such an inference. The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it.*" (Italics inserted)

The following excerpts indicate similar action by other courts. Smith v. Zemurray, (C. C. A. 5) 69 Fed. (2nd) 5, 6:

"To the appellee's 'as if' argument, 'the matter is to be treated as though Robinson had presented the check to the teller and on receiving the money had paid it back over the counter to buy a draft,' American National Bank v. Miller, 229 U. S. 520, 33 S. Ct. 883, 57 L. Ed. 1310,' the receiver replies: 'Not so. We know from Robinson's own testimony that this did not occur. We know from it that what did occur was an exchange of the paper of a bank, hopelessly insolvent, if plaintiff is right, in the form of an accepted draft on it, for paper of the same bank in the form of its draft on New York. This and nothing more.' He argues, too, that *when what actually occurred is known, it is idle to speculate on what might have been the legal effect of an entirely different occurrence.* Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288." (Italics inserted)

Wisdom v. Keen, (C. C. A. 5) 69 Fed. (2nd) 349, 350:

"This, then, is a case in which the bank and its customer definitely agreed that $1,200.00 in cash should be

held by the bank in escrow, to be delivered (not paid) on a condition and checks were given to the bank on which it was to get the cash out of its own vault. The obligation was perfect to segregate and hold the cash. *Equity if dealing with the bank alone might well consider that it had done what it should have done and might well hold it to the consequences.* American National Bank v. Miller, 229 U. S. 517, 33 S. Ct. 883, 57 L. Ed. 1310. *But in dealing with the distribution of the assets of an insolvent national bank and with the requirement of ratable dividends to all claimants a more stringent adherence to what was actually done is proper.* Here the bank agreed to segregate a trust res but never did it. By their mutual intent the bank's relation to Keen was that of a trustee rather than a debtor, but there is still no identifiable trust res traceable as such, but only a liability for a breach of trust in failing to create the res. This liability, absent a statutory priority or lien, has no higher dignity than other general liabilities. As to every general creditor the bank has failed to do what it ought to have done and what it promised to do. The federal statute puts all such claimants on an equality. Even claims due the United States have no preference. Cook County National Bank v. United States, 107 U. S. 445, 2 S. Ct. 561, 27 L. Ed. 537." (Italics inserted)

Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Co. (Supreme Judicial Court of Massachusetts) (De Courcy, J.) 136 N. E. 333-335:

"The other theory is that the transaction by which the draft was paid was in legal effect the same as if B. Greenglass & Son had drawn from their account through the paying teller the sum of $3,518.00, in money, and then handed it back to the collecting teller in payment of the draft. *But that is not what the debtor did; and the difference is essential, not a mere matter of form. The payment made to the bank was not cash,* to which the moment before it had not the slightest claim, and which therefore would count as wholly separate 'proceeds' of the collection; *it was*

> *merely the lessening of one of its own debts, and productive of nothing even remotely suggesting a 'res' for a trust. The difference between the legal significance of the actual and the assumed courses of action cannot be ignored or confused.*" (Italics inserted)

People v. Merchants & Mechanics Bank, 78 N. Y. 269:

> "The learned counsel contends that the Troy Bank was agent of the Chemical Bank to receive payment of the check. Suppose it were, *what did it receive as such payment? Simply its own obligation. If anything was set apart by charging up the check, it was only so much of the bank's indebtedness to its depositor.* * * * To make this case analogous it would be necessary to show that the Troy Bank had separated from its general assets, and placed in the hands of some depositary, a sum sufficient to pay the check, for the express purpose of being so applied, and that this fund had come to the hands of the receiver in some form. There is no approach in this case to any such state of facts." (Italics inserted)

The only Federal decision we find wherein a fiction was resorted to in allowing a trust claim against the Receiver of an insolvent National bank is that of Schumacher v. Harriett, 52 Fed. (2nd) 817 which may possibly be relied on by the respondent. The error of this decision as we see it is discussed in detail in the petitioner's brief in the companion case of Adams v. Champion, No. 374, this term. The arguments against the soundness of the Harriett decision are summarized in the recent opinions of the Circuit Court of Appeals for the Fifth Circuit as follows:

Pottorff v. Key, 67 Fed. (2nd) 833, 834:

> "Schumacher v. Harriett (C. C. A.) 52 Fed. (2nd) 817, 82 A. L. R. 1, is much relied on to sustain the judgment appealed for. The court there reviews the cases and concedes that they establish such principles as we have just asserted, but avoids their consequences *by the novel view* that a trust check, when treated by a bank

as one of its cash items, is thereby confused with its cash as though it had been unidentifiable currency; and that, if the bank misuses the check, it thereby sets apart as a trust res an equivalent value of other cash assets. *Such a doctrine amounts to saying that in every case of misapplied money or money's equivalent the wrongdoer's other cash and cash items stand in its place so long as he has any, establishing in effect a general lien on all such.* 'If the plaintiff's contention be well founded, and to follow misappropriated moneys it is only necessary to show that a receiver has, and that the trustee had, assets, the rule is simply that a demand for such moneys is a preferred claim against any substantial estate. *To adopt this view is to do away with all the equitable principles out of which the right to follow trust funds grew.*' American Can Co. v. Williams (C. C. A.) 178 F. 420, at page 423. *We hold in this connection that, if a trust res can be followed, it must be; and that a lien by confusion can be fixed on a fund only when the confusion is actual and when the fund is shown to have really received and to still contain the trust res or its proceeds.* The judgment is reversed, with direction to disallow appellee's claim as preferred and to allow it as a general claim only." (Italics inserted)

Wisdom v. Keen, 69 Fed. (2nd) 349, 350:

"The view that when a bank becomes obligated to collect for another person checks drawn on itself and makes entries of their collection, it must in equity be considered to have done what it should have done, to wit, to have collected them in cash though afterwards commingling the customer's cash thus collected with its own, so that a traceable res is brought into being with title vested in the customer, has been adopted by a growing number of State courts and is said to be the majority view in an elaborate examination of the cases in 82 A. L. R. page 97. *It was pressed to its furtherest etxent in the Fourth Circuit in Schumacher v. Harriett,* 52 Fed. (2nd) 817, 82 A. L. R. 1, *and Schumacher v. Brinson,* 52 Fed. (2nd) 821. *Otherwise the Federal cases have been to the contrary,* 82 A. L. R. 101. Schu-

macher v. Brinson was appealed and reversed as Blakey v. Brinson, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288. *We refused to follow Schumacher v. Harriett in Pottorff v. Key* (C. C. A.), 67 Fed (2nd) 833. At the conclusion of the opinion in *Texas & Pacific R. Co. v. Pottorff*, 54 S. Ct. 416, 78 L. Ed. ...., *the Supreme Court again indicates the necessity of an identifiable trust res in order to create a trust by misconduct as distinguished from a general liability in contract or tort. Whether the question be one of general equity jurisprudence or of the application of the federal law relating to insolvent national banks, the views of the Federal courts must in such courts be controlling.*" (Italics inserted)

When Circuit Judge Parker, the author of the Harriett opinion, was urged to resort to a similar fiction to establish a trust claim against an insolvent National bank while sitting as a District Judge in First National Bank of Ventura v. Williams, 15 Fed. (2nd) 585, 588, he said:

> "The answer to this is that courts must decide cases, not upon suppositions, but upon facts as proven or admitted, and the admitted fact is that cash was not received for the check, but that it was used merely to reduce the liabilities of the bank."

Of course had the collecting National Bank segregated a part of its cash or cash items and earmarked the same, the trust claim contended for could be established. The difference between segregation and non-segregation is illustrated in St. Augustine Paint Company v. McNair (C. C. A. 5) 59 Fed. (2) 755, where the bank physically segregated a part of its cash to purchase the claimant's check held for collection. The court in its opinion at page 757 said:

> "The conversion of the check into cash and segregation of such cash from the bank's general assets before using the check are of vital consequence, as those facts distinguish that transaction from those in which a bank of deposit merely credited a check to the depositor's account so as to become the depositor's debtor, and

thereafter used the check to pay the bank's own debts in such a manner that the proceeds were absorbed in a clearing transaction with no gain to the receiver, such as in Empire State Surety Co. v. Carroll Co. (C. C. A. 8) 194 Fed. 593, and other cases cited." (Italics inserted)

The respondent has filed a supplemental brief wherein it designates certain statements in the brief of the Comptroller of the Currency as amicus curiae as "erroneous" or "incorrect". It is submitted that all statements contained in the amicus curiae brief are amply supported by the authorities cited therein and in this brief. Nothing contained in the Comptroller's brief is withdrawn or modified except the statement that this case turns on the tracing of funds feature. The claim in the instant case is general only because of complete inability to trace any proceeds to the Receiver. No res exists and consequently there is no trust relationship. Accordingly as in Blakey v. Brinson, *supra*, it should not be necessary to consider the tracing of funds questions.

The national banking laws, and related Acts, together with a long line of decisions by this Court, clearly evidence an intent to safeguard the assets of insolvent National banks, in liquidation, thus insuring a maximum distribution to the depositors and creditors. Taxes due the United States which would be paid from the funds of depositors are abated. (Sec. 570, Title 12 U. S. C. A.) The preference given the United States as a sovereign against insolvent estates generally is inapplicable to such banks. Suits to wind up the affairs of such banks are made cognizable in the Federal courts, *independent of the amount involved.* A separate system of liquidation is provided, independent of the Bankruptcy Act. Sales and compromises of assets can be made only after court approval and advances to protect assets can be made only upon approval by the Secretary of the Treasury. Annual reports of the results of liquidation are required to be made to Congress. While

the claimants in the instant case (and in the companion cases Nos. 340 and 374) assert ownership of property taken over by the Receivers they are in fact, as established by the record, seeking to be made whole from the funds of the depositors. To permit any class of claimants to be paid in full from the funds of depositors, when such funds were in no way enriched by the claimants' transactions, would flagrantly violate the principles heretofore adhered to in liquidating insolvent National banks.

The depositors and other creditors of this insolvent National bank—the beneficial owners of all its assets—will suffer a very substantial loss because of their dealings with the bank. The equities of these depositors and other creditors are at least equal to those of the respondent. The record establishes that no part of the assets that passed to the Receiver came into the bank as a result of the respondent's transaction. All of the assets that passed to the Receiver came into the bank as the result of transactions other than the respondent's. None of the assets of the bank were segregated to respond for the respondent's claim under the provisions of the Bank Collection Code and no segregation was intended by that statute. Section 13 of the Bank Collection Code is inapplicable to insolvent National banks. Under these circumstances the court below should have found for the bank Receiver and classified the respondent's claim as general only.

(C) The jurisdiction of the District Court is limited to the determination of the validity of the trust claim asserted, and to a direction to the Receiver to certify the claim to the Comptroller of the Currency for payment in due course of administration. The court below should have reversed the District Court's order to the Receiver to pay forthwith; should have dissolved the permanent injunction issued by the District Court restraining the Receiver from disposing of the bank's assets as required by the National Bank Act, and should have allowed a general claim.

The court below should have reversed the District Court's order to the Receiver to pay a sum of money forthwith and should have dissolved the permanent injunction issued by the District Court restraining the Receiver from disposing of the bank's assets as required by the National Bank Act.

It is the position of the bank Receiver that all that is said in the following excerpts from opinions by this court concerning the lack of authority of State courts to in any way control the assets of a National bank being liquidated through a Receiver appointed by the Comptroller of the Currency is equally applicable to the Federal courts:

Earle v. Pennsylvania, 178 U. S. 449, 454:

> "We must not, however, be understood as holding that the distribution of the bank's assets in the hands of the receiver could have been in anywise directly controlled by the state court or seized under an attachment or execution in the hands of any state officer. On the contrary, the direction in the statute that the receiver pay over all moneys realized by him from the assets of the bank to the Treasurer of the United States, subject to the order of the Comptroller, furnished a rule of conduct for him which neither an order of nor any proceedings in the state court could affect, modify or change. The scheme of the statute relating to suspended national banks is that from the time of a bank's suspension all its assets, of whatever kind, as they are at the time of suspension, pass in the first instance, to the receiver, the proceeds thereof to be distributed by the Comptroller among those whose claims are proved to his satisfaction or are adjudicated by some court of competent jurisdiction. So when the Chestnut Street National Bank suspended and went into the hands of a receiver the entire control and administration of its assets were committed to the receiver and the Comptroller, subject, however, to any rights of priority previously acquired by the plaintiff through the proceedings in the suit against Long."

Earle v. Conway, 178 U. S. 456, 457:

> "No sound reason can be given why the receiver of a National bank may not be notified by service upon him of an attachment issued from a state court of the nature and extent of the interest asserted or sought to be acquired by the plaintiff in the attachment in the assets in his custody. But for the reasons stated in Earle v. Pennsylvania, such an attachment cannot create any lien upon specific assets of the bank in the hands of the receiver, nor disturb his custody of those assets, nor prevent him from paying to the Treasurer of the United States, subject to the order of the Comptroller of the Currency, all moneys coming to his hands or realized by him as receiver from the sale of the property and assets of the bank. After the service of the attachment upon the receiver it became the duty of the latter to hold any funds coming to his hands through the Treasurer of the United States as the proceeds of the sale of the bank's assets subject to any interest which the plaintiff may have legally acquired therein as against his debtor under the attachment issued on the judgment in his favor in the state court."

In the instant case the respondent does not seek the return of specific property it claims to own but seeks to impress a trust on the cash and cash items of the collecting National bank because of an alleged commingling of its property. Under the provisions of Section 194, Title 12, U. S. C. A., claims against the bank's cash and cash items may be proved to the satisfaction of the Comptroller or determined in a court of competent jurisdiction. In distributing the proceeds of property that comes into his hands as apparent assets of an insolvent National bank, the Comptroller always endeavors to take cognizance and give full effect to the final decisions of Federal or State courts involving claims against such bank. If the trial court had jurisdiction to direct payments forthwith from the bank's cash and cash items or enjoin the disposition of the same it could direct the payment of the entire amount thereof to one claimant. Other claimants who may have proved trust

claims against the cash and cash items to the satisfaction of the Comptroller, as permitted by the statute, would thus be denied payment as contemplated by the Act. Only where claims found valid by the courts are directed to be certified to the Comptroller of the Currency for payment in due course of administration can the rights of all concerned be protected, because the bank's assets, including all apparent assets, are in the hands of the Comptroller for distribution. The cash that passed to the Receiver of the collecting National bank and the proceeds of the cash items that passed into his hands had been transferred to the Comptroller of the Currency prior to the issuance of the trial court's injunction, and consequently the injunction would have to issue against the Comptroller of the Currency, who was not within the jurisdiction of the court.

The trial court's direction to the Receiver to pay forthwith might result in the Receiver being held in contempt for not paying over moneys which are not within his control. In this connection the Circuit Court of Appeals for the Fifth Circuit in Richardson v. Louisville Banking Company, 94 Fed. 442, 449, said:

> "An objection is made to the form of the decree rendered in the court below, in that it commands the receiver to pay over to the complainant a certain large sum of money within 10 days, when, as a matter of fact, and in accordance with law, the receiver is not in personal custody of the funds in question, but the same are in the hands of the comptroller of the currency. The effect of the decree, as rendered, might be that the receiver would be in contempt for not paying over moneys which are not within his control. See Merrill v. Bank, 41 U. S. App. 529, 21 C. C. A. 282, and 75 Fed. 148."

In Merrill v. First National Bank of Jacksonville (C. C. A. 5), 75 Fed. 148, 153, the court, in its opinion, said:

> "In general, the receiver of a National bank has been held to be a mere instrument of the Comptroller, and

subject in all respects to his instruction. Kennedy v. Gibson, 8 Wall. 498; Bank v. Kennedy, 17 Wall. 21. In Eastern Townships Bank v. Vermont National Bank, 22 Fed. 186, the proper form of a decree in a case similar to the one in hand was considered in reference to section 5236, Rev. St., and Case v. Bank, 100 U. S. 446. It was held that judgments in such cases should be certified by the receiver through the Comptroller, and be paid in due course of administration. In Case v. Bank, *supra,* the judgment was, after reciting the amount of the demand, etc., as follows:

> 'That Frank F. Case, receiver, do recognize the said Citizens Bank of Louisiana as creditor, * * * and that he do pay the same or certify the same to the Comptroller, to be paid in due course of administration; * * * and that the Citizens Bank of Louisiana do receive, before further payment to creditors, its due proportion of dividends pro rata with those already paid to the creditors of the Crescent City National Bank.'

"In this case it does not appear that the form of the judgment was contested, but in affirming the judgment the court did say:

> 'Beyond all doubt, the validity of their debt is established by the verdict and judgment; and, if so, it requires neither argument nor authorities to show that the order given by the circuit court to provide for the payment of the amount recovered was proper and correct.' Id. 456."

This injunction question was considered by the Circuit Court of Appeals of the Second Circuit in American Can Co. v. Williams, 149 Fed. 200, affirmed 153 Fed. 882, where the right to enjoin was sustained in a divided opinion. The bank Receiver submits, however, in view of the fact that the Comptroller of the Currency alone can do justice to all parties, that the law is correctly stated in the following dissenting opinion of Judge Townsend (149 Fed. 200):

> "I dissent from the opinion of the majority of the court. The order in question enjoins the receiver 'from

disposing in any manner of any funds in his hands as receiver of the Fredonia National Bank by transmission to the Treasurer of the United States or otherwise, so as to reduce' the amount claimed by the plaintiff as a preference in the pending suit.

"The Federal statute makes it the duty of the defendant to take possession of the assets of the insolvent institution, and to pay over all moneys resulting therefrom to the Treasurer of the United States, subject to the order of the Comptroller. There is no evidence that the defendant is doing or threatens to do any act in violation of the plaintiff's right. It would seem from the language of section 5236 of the Revised Statutes (U. S. Comp. St. 1901, p. 3508) that the comptroller and not the defendant, would be the proper person to pay the plaintiff's claim if it were finally sustained. In the absence of evidence that unless the injunction issue there will be an invasion of the plaintiff's rights, there is no sufficient justification therefor. The right to a preliminary injunction is not granted ex debito justitiae, but the application is addressed to the sound discretion of the court. The discretion is not an arbitrary one, but is to be exercised subject to the established principles of law. High on Injunctions, Sec. 11, 13.

"*It is to be assumed that the receiver, the Treasurer and the Comptroller will execute their duties according to law.* I am of the opinion therefore, that no adequate ground has been shown to justify the interference by injunction with the executive officers of the Government in the discharge of their duties in accordance with the statute." (Italics inserted.)

This dissenting opinion seems to be fortified by the following excerpt from the very recent decision of the Circuit Court of Appeals, Fifth Circuit in Taylor v. Spurway, et al., 72 Fed. (2nd) 97. 99:

"It is contended by the appellee that he has no fund in his custody as it is the duty of a receiver of a national bank to cover all moneys coming into his hands in liquidation of the bank's affairs into the treasury, subject to the order of the Comptroller who alone has

power to declare dividends. While this is true, the receiver is required to conduct his affairs with honesty and fair dealing, and a suit will lie against him to determine the rights of parties claiming a lien on assets in his hands. Merrill v. National Bank of Jacksonville, 173 U. S. 131, 19 S. Ct. 360, 43 L. Ed. 640. If it should transpire that the receiver has no funds to respond to a judgment, *it must be assumed that the Comptroller, although beyond the reach of process of the court rendering the judgment, will give effect to a valid judgment of a court of competent jurisdiction.* Earle v. Pennsylvania, 178 U. S. 449, 20 S. Ct. 915, 44 L. Ed. 1146. We are not aware of any case in which the receiver of a national bank has been enjoined from disposing of funds in his custody, but he is not above the law and, if he be guilty of such gross fraud as alleged, a court of equity undoubtedly would have authority to do so." (Italics inserted.)

The bank Receiver submits that even though the respondent's claim shall be classified as general only, consideration should be given by this Court to the propriety of the District Court's issuance of a permanent injunction and order to pay forthwith, because the bank Receiver has been restrained since September 13, 1933, from disposing of a part of the bank's assets in the manner prescribed by the National Bank Act.

VII.

CONCLUSION.

It is believed that the foregoing discussion establishes that no trust arose in the present case; that the assets of the collecting National Bank were not augmented by the collection of the respondent's check; that no trust res can be traced to the assets acquired by the bank Receiver; that the dignity of the respondent's claim is in no way increased by any of the provisions of the Bank Collection Code; that the court below should have reversed the trial court's direction to the Receiver to pay forthwith and should have dis-

solved the injunction issued by the trial court; and that an affirmance may be construed to mean the overruling of the great body of Federal decisions requiring the existence of a trust res and the tracing of the same to the Receiver or that a State statute in conflict with the National Bank Act can be made applicable in the liquidation of an insolvent National bank.

It is submitted that the decision of the court below should be reversed.

Respectfully submitted,

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APPENDIX.

U. S. C. A. Title 12, Sec. 194.

DIVIDENDS ON ADJUSTED CLAIM; DISTRIBUTION OF ASSETS. From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. Sec. 5236)

PROGRAM OF STATE LEGISLATION 1929—PART 2.

Recommended by the
AMERICAN BANKERS ASSOCIATION

BANK COLLECTION CODE.

Draft prepared jointly by Thomas B. Paton and Thomas B. Paton, Jr., General Counsel and Assistant General Counsel, American Bankers Association, with explanatory notes, and designed for uniform enactment in all the states.

Issued under the auspices of the Committee on State Legislation,
AMERICAN BANKERS ASSOCIATION

FOREWORD.

There has long been need for a uniform code of rules governing bank collections which will give the sanction of law to modern customs and practices of banks and obviate the necessity for the printing of special agreements on deposit slips, pass books and other literature for their protection. Not only are existing rules growing out of earlier conditions which no longer obtain, unsuited to present conditions, but the conflict of such rules, as established in the different states, makes uniformity a desideratum especially as the currency of checks and other paper is nation-wide in scope and the rules governing the collection and payment of such paper should be uniform, irrespective of state lines.

To accomplish the purpose of uniformity and modernization of the law governing bank collections, three successive tentative drafts of a bank collection code have been prepared and submitted to various bankers, expert in the practice of check collection, to attorneys for banks and to mem-

bers of the Committee on State Legislation and the State Legislative Council of the American Bankers Association for their suggestions and criticism.

The third tentative draft was approved in substance at the meeting on October 1, 1928, of the Committee on State Legislation subject to technical changes which the General Counsel was authorized to make preliminary to its being urged by the Committee on State Legislation through state bankers associations for enactment by the legislatures of the different states and this action was approved by the Executive Council at that time.

As finally drafted, the code is now presented to the members of the State Legislative Committee and the State Legislative Council in the various states and to Secretaries of the state bankers associations for their consideration and approval of the appropriate committees of such state associations preparatory to being urged through their associations at the 1929 and subsequent sessions of the state legislatures.

It is hoped the detailed provisions herein will prove to be practicable and can be uniformly enacted although the draft still must be regarded, in a measure, as tentative rather than a completed draft. Due to the complications of the subject it is a difficult one to regulate with scientific exactness. Attention is particularly invited to the provision that is contained in Section 11 which continues the liability of the maker and prior parties upon a check presented by mail to a drawee which defaults in payment. Montana has already adopted such principle of liability as part of its legislation, the theory being that a depositor who tenders his check which requires mailing for payment, should not escape liability to his creditor where the bank which he has designated to make payment cannot make good. It will be noted that this section merely gives an option to the holder to dishonor his check and preserve his liability; the option need or need not be exercised. If not exercised, then the drawer of the check is dicharged if the drawee charges it to his account but in such case there arises a preference in the assets of the insolvent bank in favor of the owner.

BANK COLLECTION CODE

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AN ACT TO EXPEDITE AND SIMPLIFY THE COLLECTION AND PAYMENT BY BANKS OF CHECKS AND OTHER INSTRUMENTS FOR THE PAYMENT OF MONEY.

Be it enacted

SECTION 1. [Definitions.] For the purposes of this code:

(A) Bank. The term "bank" shall include any person, firm or corporation engaged in the business of receiving and paying deposits of money within this state. A branch or office of any such bank shall be deemed a bank for the purpose of this act.

(B) Item. The term "item" means any check, note or other instrument providing for the payment of money.

SECTION 2. [Bank Is Agent for Collection.]

Except as otherwise provided by agreement and except as to subsequent holders of a negotiable instrument payable to bearer or indorsed specially or in blank, whether an item is deposited or received for collection, the bank of deposit shall be agent of the depositor for its collection and each subsequent collecting bank shall be sub-agent of the depositor but shall be authorized to follow the instructions of its immediate forwarding bank and any credit given by any such agent or sub-agent bank therefor shall be revocable until such time as the proceeds are received in actual money or an unconditional credit given on the books of another bank, which such agent has requested or accepted. Where any such bank allows any revocable credit for an item to be withdrawn, such agency relation shall nevertheless continue except the bank shall have all the rights of an owner thereof against prior and subsequent parties to the extent of the amount withdrawn.

SECTION 3. [Item on Same Bank.]

A credit given by a bank for an item drawn on or payable at such bank shall be provisional, subject to revocation at or before the end of the day on which the item is deposited in the event the item is found not payable for any reason. Whenever a credit is given for an item deposited after banking hours such right of revocation may be exercised during the following business day.

SECTION 4. [Legal Effect of Indorsements.]

An indorsement of an item by the payee or other depositor "for deposit" shall be deemed a restrictive indorse-

ment and indicate that the indorsee bank is an agent for collection and not owner of the item.

An indorsement "pay any bank or banker" or having equivalent words shall be deemed a restrictive indorsement and shall indicate the creation of an agency relation in any subsequent bank to whom the paper is forwarded unless coupled with words indicating the creation of a trustee relationship; and such indorsement or other restrictive indorsement whether creating an agency or trustee relationship shall constitute a guaranty by the indorser to all subsequent holders and to the drawee or payor of the genuineness of and the authority to make prior indorsements and also to save the drawee or payor harmless in the event any prior indorsement appearing thereon is defective or irregular in any respect unless such indorsement is coupled with appropriate words disclaiming such liability as guarantor.

Where a deposited item is payable to bearer or indorsed by the depositor in blank or by special indorsement, the fact that such item is so payable or indorsed shall not change the relation of agent of the bank of deposit to the depositor, but subsequent holders shall have the right to rely on the presumption that the bank of deposit is the owner of the item. The indorsement of an item by the bank of deposit or by any subsequent holder in blank or by special indorsement or its delivery when payable to bearer, shall carry the presumption that the indorsee or transferee is owner provided there is nothing upon the face of the paper or in any prior indorsement to indicate an agency or trustee relation of any prior party. But where an item is deposited or is received for collection indorsed specially or in blank, the bank may convert such an indorsement into a restrictive indorsement by writing over the signature of the indorser the words "for deposit" or "for collection," or other restrictive words to negative the presumption that such bank of deposit or indorsee bank is owner; and in the case of an item deposited or received for collection payable to bearer, may negative such presumption by indorsing thereon the words "received for deposit" or "received for collection" or words of like import.

SECTION 5. [Duty and Responsibility of Bank Collecting Agents.]

It shall be the duty of the initial or any subsequent agent collecting bank to exercise ordinary care in the collection of

an item and when such duty is performed such agent bank shall not be responsible if for any cause payment is not received in money or an unconditional credit given on the books of another bank, which such agent bank has requested or accepted. An initial or subsequent agent collecting bank shall be liable for its own lack of exercise of ordinary care but shall not be liable for the neglect, misconduct, mistakes or defaults of any other agent bank or of the drawee or payor bank.

SECTION 6. [Rules of Ordinary Care in Forwarding and Presentment.]

(A) Where an item is received on deposit or by a subsequent agent bank for collection, payable in another town or city, it shall be deemed the exercise of ordinary care to forward such item by mail, not later than the business day next following its receipt either (1) direct to the drawee or payor in the event such drawee or payor is a bank or (2) to another bank collecting agent according to the usual banking custom, either located in the town or city where the item is payable or in another town or city.

(B) Where an item is received on deposit or by a subsequent agent bank for collection, payable by or at another bank in the same town or city in which such agent bank is located, it shall be deemed the exercise of ordinary care to present the item for payment at any time not later than the next business day following the day on which the item is received either (1) at the counter of the drawee or payor by agent or messenger or (2) through the local clearing house under the regular established procedure, or according to the usual banking custom where the collecting or payor bank is located in an outlying district.

(C) The designation of the above methods shall not exclude any other method of forwarding or presentment which under existing rules of law would constitute ordinary care.

SECTION 7. [Items Received Through the Mail.]

Where the item is received by mail by a solvent drawee or payor bank, it shall be deemed paid when the amount is finally charged to the account of the maker or drawer.

SECTION 8. [Items Lost in Transit.]

Where an agent bank forwards an item for collection, it shall not be responsible for its loss or destruction in transit or, when in the possession of others, for its inability to

repossess itself thereof, provided there has been no lack of ordinary care on its part.

SECTION 9. [Medium of Payment.]

Where ordinary care is exercised, any agent collecting bank may receive in payment of an item without becoming responsible as debtor therefor, whether presented by mail, through the clearing house or over the counter of the drawee or payor, in lieu of money, either (a) the check or draft of the drawee or payor upon another bank or (b) the check or draft of any other bank upon any bank other than the drawee or payor of the item or (c) such method of settlement as may be customary in a local clearing house or between clearing banks or otherwise: provided that whenever such agent collecting bank shall request or accept in payment an unconditional credit which has been given to it on the books of the drawee or payor or on the books of any other bank, such agent collecting bank shall become debtor for such item and shall be responsible therefor as if the proceeds were actually received by it in money.

SECTION 10. [Medium of Remittance.]

Where ordinary care is exercised, any agent collecting bank may receive from any subsequent bank in the chain of collection in remittance for an item which has been paid, in lieu of money, the check or draft of the remitting bank upon any bank other than itself or the drawee or payor of the item or such other method of settlement as may be customary: provided that whenever such agent collecting bank shall request or accept an unconditional credit which has been given to it on the books of the remitting bank or on the books of any other bank, such agent collecting bank shall become debtor for such item and shall be responsible therefor as if the proceeds were actually received by it in money.

SECTION 11. [Election to Treat as Dishonored Items Presented by Mail.]

Where an item is duly presented by mail to the drawee or payor, whether or not the same has been charged to the account of the maker or drawer thereof or returned to such maker or drawer, the agent collecting bank so presenting may, at its election, exercised with reasonable diligence, treat such item as dishonored by non-payment and

recourse may be had upon prior parties thereto in any of the following cases:

(1) Where the check or draft of the drawee or payor bank upon another bank received in payment therefor shall not be paid in due course;
(2) Where the drawee or payor bank shall without request or authority tender as payment its own check or draft upon itself or other instrument upon which it is primarily liable;
(3) Where the drawee or payor bank shall give an unrequested or unauthorized credit therefor on its books or the books of another bank; or
(4) Where the drawee or payee shall retain such item without remitting therefor on the day of receipt or on the day of maturity if payable otherwise than on demand and received by it prior to or on such day of maturity.

Provided, however, that in any case where the drawee or payor bank shall return any such item unpaid not later than the day of receipt or of maturity as aforesaid in the exercise of its right to make payment only at its own counter, such item cannot be treated as dishonored by nonpayment and the delay caused thereby shall not relieve prior parties from liability.

Provided further that no agent collecting bank shall be liable to the owner of an item where, in the exercise of ordinary care in the interest of such owner, it makes or does not make the election above provided or takes such steps as it may deem necessary in cases (2), (3) and (4) above.

SECTION 12. [Notice of Dishonor of Items Presented by Mail.]

In case of the dishonor of an item duly presented by mail as provided for in the next preceding section, notice of dishonor of such item to prior parties shall be sufficient if given with reasonable diligence after such dishonor; and further in the event of failure to obtain the return of any such item notice of dishonor may be given upon a copy of written particulars thereof, and delay in giving notice of dishonor caused by an attempt with reasonable diligence to obtain return of such item shall be excused.

SECTION 13. [Insolvency and Preferences.]

1. When the drawee or payor, or any other agent collecting bank shall fail or be closed for business by (official to be designated) or by action of the board of directors or by other proper legal action, after an item shall be mailed or otherwise entrusted to it for collection or payment but before the actual collection or payment thereof, it shall be the duty of the receiver or other official in charge of its assets to return such item, if same is in his possession, to the forwarding or presenting bank with reasonable diligence.

2. Except in cases where an item or items is treated as dishonored by non-payment as provided in Section 11, when a drawee or payor bank has presented to it for payment an item or items drawn upon or payable by or at such bank and at the time has on deposit to the credit of the maker or drawer an amount equal to such item or items and such drawee or payor shall fail or close for business as above, after having charged such item or items to the account of the maker or drawer thereof or otherwise discharged his liability thereon but without such item or items having been paid or settled for by the drawee or payor either in money or by an unconditional credit given on its books or on the books of any other bank, which has been requested or accepted so as to constitute such drawee or payor or other bank debtor therefor, the assets of such drawee or payor shall be impressed with a trust in favor of the owner or owners of such item or items for the amount thereof, or for the balance payable upon a number of items which have been exchanged, and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

3. Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above, after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, the assets of such agent collecting

bank which has failed or been closed for business as above shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank.

SECTION 14. [Act not Retroactive.]

The provisions of this act shall not apply to transactions taking place prior to the time when it takes effect.

SECTION 15. [Cases not Provided for in Act.]

In any case not provided for in this act the rules of law and equity, including the law merchant and those rules of law and equity relating to trusts, agency, negotiable instruments and banking, shall continue to apply.

SECTION 16. [Uniformity of Interpretation.]

This act shall be so interpreted and construed as to effectuate its general purpose to make uniform the law of those states which enact it.

SECTION 17. [Short Title.]

This act may be cited as the bank collection code.

SECTION 18. [Inconsistent Laws Repealed.]

All acts or parts of acts inconsistent with this act are hereby repealed.

SECTION 19. [Time of Taking Effect.]

This act shall take effect [ ].

EXPLANATORY NOTES

SECTION 1. [Definitions.]

The definition of the term "bank" is broad enough to include all banks whether organized under State or Federal laws. The definition also recognizes that for purposes of presentment and payment of paper a branch or office of a bank is regarded as a separate and distinct institution.

The term "item" as defined includes nonnegotiable as well as negotiable instruments.

SECTION 2. [Bank of Deposit Is Agent for Collection.]

The purpose of this section is to establish an agency relation of the bank in which paper is deposited and thus protect it, when paper is deposited indorsed unrestrictedly, which is oftentimes the case, from being held liable to its

depositor as owner, as soon as credited to his account. This was so held in City of Douglas v. Federal Reserve Bank, 46 Sup. Ct. 554, notwithstanding there was a custom to charge back in event of dishonor and the contract provided that out-of-town items were expressly credited "subject to final payment." It was pointed out that in the event of dishonor, the bank could ordinarily have recourse upon the depositor as indorser, but in the particular case, the indorser was discharged, because the item had been paid by a worthless draft of the drawee bank, which failed and the bank of deposit was the loser. Banks generally protect themselves by stipulations on deposit slips, signature cards or pass-books against such liability, by declaring that the bank is agent not owner. The above section provides a statutory relation of agency in the absence of agreement to the contrary, but if the bank receives the paper unrestrictedly indorsed, it becomes liable as owner to subsequent parties who act in reliance upon its ownership unless it protects itself as provided in Section 4.

Subsequent collecting banks are defined as sub-agents of the depositor but are authorized to follow instructions of the immediate forwarding bank.

Credits given by agent banks for uncollected paper are revocable and do not make the bank responsible as debtor until the proceeds have been received in money or an unconditional credit therefor has been given which has been requested or accepted (see Secs. 9 and 10). The provision making the bank debtor where an unconditional credit is given which has been requested or accepted applies in all cases where the presentment is by mail, over the counter or through the clearings and is based upon the principle that the bank should be responsible as debtor where it becomes owner of a credit which it is not compelled to accept but which it does accept on its own responsibility upon the books of another bank which fails.

SECTION 3. [Item on Same Bank.]

The majority of courts hold that credit of an item on the same bank is final and cannot be charged back, notwithstanding such item is found not good upon examination of the account. The theory, is that the bank is presumed to know at all times the condition of a customer's account. While it is the bank's duty to the drawer-customer of a check to pay or reject it immediately, the courts have held

that it is competent for the bank to agree with the payee-depositor that payment be deferred for a reasonable time in order to examine the account. In banking practice, deposited checks on the same bank are immediately credited in the depositor's pass-book without opportunity for examination of the drawer's account at the moment and it is clearly unreasonable for the depositor of an item drawn on the same bank to expect an irrevocable credit until the bank has had a reasonable time to inquire into the account. The code fixes a definite rule that such credit shall be provisional subject to revocation which the bank might exercise at any time during the day.

SECTION 4. [Legal Effect of Indorsements.]

The Negotiable Instruments Act defines the legal meaning and effect of certain kinds of indorsements, such as indorsements in blank and special indorsements, which convey title, indorsements "without recourse" which convey title but without liability for non-payment, conditional indorsements which convey title subject to a condition and restrictive indorsements which either constitute the indorsee the agent of the indorser or which vest title in the indorsee as trustee. As to the latter class of indorsements, the courts are in conflict whether certain forms of indorsements are restrictive and agent-creating or unrestricted and title-conveying and Section 4 is designed to clear up this conflict in the case of indorsements "for deposit" and "pay any bank or banker" which have been held both agent-creating and title-conveying in different jurisdictions.

The first paragraph of Section 4 provides the legal effect of an indorsement "for deposit" making same restrictive and providing that the bank is agent and not owner.

The indorsement "pay any bank or banker" is likewise made restrictive and creating an agency relation "unless coupled with words indicating the creating of a trustee relationship." Many collecting banks stamp upon items various forms of which the following is a sample:

> "This Draft is a CASH ITEM and is not to be treated as a deposit The funds obtained thru its collection are to be accounted for to us as a trust and are not to be commingled with other funds of collecting bank."

The words "unless coupled" etc., are inserted to cover such condition.

The section further provides not only in the case of indorsements "pay any bank or banker" but in all cases of restrictive indorsements, whether creating an agency or trust relationship, that such indorsements carry a guaranty of genuineness and authority to make prior indorsements and to save the drawee harmless in case of defective or irregular prior indorsements Most restrictive indorsements are coupled with a guaranty of prior indorsements and drawee banks generally require such guaranty as a prerequisite of payment. It seems proper, therefore, to have this feature incorporated in the law; but it is qualified by the provision "unless such indorsement is coupled with appropriate words disclaiming such liability as guarantor." This would enable any forwarding bank that did not desire to incur a guarantor liability to couple with its indorsement a disclaimer, such as "without guarantor liability" or other form of disclaimer.

The Code provides that where a deposited item is payable to bearer or is indorsed in blank or specially, the bank of deposit remains agent but subsequent holders have the right to rely on the presumption that the bank of deposit is owner; also that like indorsement or delivery of bearer paper by a bank of deposit or a subsequent holder carries like presumption that the indorsee or transferee is owner where there is nothing on the face of the paper or in any prior indorsment to indicate an agency relation of any prior party This provision of the Code is in harmony with existing law, for example (we quote from *Paton's Digest*, Volume 2, pages 1134 and 1135):

> "In Park Bank v. Seaboard Bank, 114 N. Y. 28, a check on the Park Bank for $8. was raised by the payee to $1,800., indorsed *in blank* by him and delivered to the Eldred (Pa.) Bank for collection only. The Eldred Bank endorsed it 'for collection' to the Seaboard Bank in New York, and that bank received payment. It was held that the Seaboard, appearing by the indorsement to be a mere agent, was not liable after it had paid over the money to its principal, the Eldred Bank. Later, in an action by the Park Bank directly against the Eldred Bank, 90 Hun. 285, it was held the

> Eldred Bank was liable, because it was apparently owner of the draft, although, in fact, agent for collection only. The court said: 'In the case of the Seaboard Bank, the agency was disclosed; in the case of the Eldred Bank, it was not. In the presentation of the draft the Eldred Bank represented itself to be the owner of the draft, and the payment was made by plaintiff under those circumstances. It does not seem to need the citation of authorities to show that where money is paid upon a raised draft without any negligence on the part of the person paying the same, it can be recovered from the party to whom it was paid.' ''

It is common for depositors to indorse checks in blank when they are placed on deposit, or specially to the bank, and probably not all banks realize that under such indorsement, although as between bank and depositor, the bank is agent, yet as to all subsequent holders and especially the payor, the bank is liable as apparent owner, in case of raised or altered checks or should the payee's indorsement be a forgery. It has, therefore, been deemed wise to insert a provision that where an item is so deposited or received for collection, the bank may negative the presumption of ownership by writing over the signature of the indorser the words "for deposit" or other restrictive words. This authority would apply to any bank in the collection chain.

SECTION 5. [Duty and Responsibility of Bank Collecting Agents.]

This section is intended to clear up the wide conflict between those decisions holding that the collecting bank is liable for the negligence and defaults of correspondents and those holding the bank not liable, provided it exercises due care. Because of such conflicting decisions and uncertainty in the law of those states where no rule has been declared, the Code provides a definite rule of liability for default of correspondents, namely, the "due care" rule, known as the Massachusetts rule, which is now followed in a majority of the states. In those states following the so-called "New York rule" that a collecting bank is liable for defaults of correspondents and in the other states where the question is unsettled, the banks are compelled to protect themselves by a special agreement. The weight of authority and the better reasoning is in favor of the Massachusetts rule. A

person depositing items is aware that the bank cannot collect it through its personal agents and employees; the ordinary exchange charge, if there is one, is very small, in comparison to the service rendered, and the liabilities assumed by the bank if it be held responsible for the acts and conduct of its correspondent bank beyond the measure of care required in selecting a suitable correspondent, is out of all proportion to such charge.

SECTION 6. [Rules of Ordinary Care in Forwarding and Presentment.]

This section in effect enacts into law the usual banking custom in regard to forwarding and presenting paper.

Custom has sanctioned the practice of forwarding direct to the drawee or payor bank, contrary to the judicial rule that such method of forwarding is negligence, and the enactment of the American Bankers Association recommended measure which authorizes such practice, now in force in the majority of states, has legalized this custom. The Code makes this rule uniform in all states and also legalizes the customary mode of presenting through bank correspondents.

SECTION 7. [Items Received Through the Mail.]

It has always been an uncertain question as to what time in the physical handling of a check received through the mail it is deemed paid. It is to the interest of the drawee or payor bank to fix a definite point of time at which the item shall be deemed paid to avoid trouble and litigation where, for example, an attachment is levied against the customer's account while the check is in possession of the drawee bank or where the drawer seeks to stop payment. The provision only has application to a solvent drawee or payor.

SECTION 8. [Items Lost in Transit.]

While the law is at the present time in accord with the above, a bank will frequently have trouble with its depositor, where the latter has apparently kept no record of the source of an item and it is difficult to get him to assume responsibility and procure a duplicate. When the non-liability of the bank is established in a definite provision of law, it makes it easier to deal with the depositor on this troublesome question. A similar provision is now a part of the statutory law of California.

SECTION 9. [Medium of Payment.]

Methods of payment may be classified as (1) money (2) draft on a bank (3) credit and (4) set-off of exchanged items with settlement of balance by either one of the first three methods.

The principle of Section 9 is to authorize the agent collecting bank to receive, instead of money, without being responsible therefor as debtor, the customary method of settlement for an item by draft on another bank or by exchange of items and settlement of balance by money or draft.

The acceptance of a draft on another bank is the ordinary method of transferring the funds from the custody of the payor bank. If, however, the agent collecting bank, instead of accepting money or such draft on another bank, chooses to allow the money to remain with the payor bank and the latter to remain debtor, by accepting a credit on its books, or an unconditional credit on the books of any other bank, this method of settlement of the agent bank's own choosing, under which the payor or some other bank is allowed to remain debtor, instead of the fund being transmitted to the owner, makes the agent collecting bank itself responsible as debtor therefor.

SECTION 10. [Medium of Remittance.]

This applies the principle underlying Section 9 to the case of the remitting bank, after the proceeds are collected.

SECTION 11. [Election to Treat as Dishonored Items Presented by Mail.]

The purpose of this Section is to permit the agent collecting bank, at its option, to continue the liability of the drawer or maker and indorsers upon a check, not presented over the counter or through the clearing house, but by mail, where the drawee or payor defaults in making payment because of its insolvency.

Presentment direct to the drawee by mail (as distinguished from mailing to an independent agent at the place of the drawee) is customary and legally sanctioned by statute in a number of states and by this Code and it is the opinion of a number of banking experts (although all are not agreed) that the drawer who gives his check upon a bank which cannot pay, should not be relieved of his obligation by the mere charging of the check to his account and the issuance by the drawee of a worthless draft therefor

but should stand for the solvency of his bank, which is his paying agent, until the latter's draft is at last paid.

Accordingly four contingencies are provided in which the item may be dishonored and the liability of the drawer continued at the option of the agent collecting bank. Where such liability is continued, the recourse is upon the drawer and prior parties and not upon the failed bank. In any case where it is found impracticable, by reason of inability to identify prior parties to an item forwarded to the drawee for which it has attempted to settle in any of the ways above mentioned, the option need not be exercised and in such event the draft or credit given by the drawee or payor will operate as payment of the original item and the owner will have recourse as preferred creditor under Section 13.

Should it be found undesirable in any state to adopt the policy declared in this section the same can be omitted; and in such event Section 12 should also be omitted and also the opening words in paragraph 2 of Section 13, "Except in cases where an item or items is treated as unpaid and dishonored as provided in Section 11."

SECTION 12. [Notice of Dishonor of Items Presented by Mail.]

The purpose of this section is to supplement the Negotiable Instruments Act which provides for notice of dishonor to preserve the liability of prior parties when an instrument is dishonored by non-acceptance or non-payment. It is intended to cover the new forms of dishonor provided in Section 11. The general requirements of the Negotiable Instruments Act as to giving notice of dishonor will still apply.

SECTION 13. [Insolvency and Preferences.]

There is much conflict in the decisions over the right to preference in payment of collection proceeds out of the assets of a failed bank. The purpose of this section is to establish uniform rules based on the better reasoned decisions. Except where the failed bank (whether drawee or payor or other collecting bank) has been accepted as debtor for such proceeds by reason of a requested or accepted credit given by it on its own books or on the books of any other bank, a trustee relation is created with respect to such proceeds both in the case of the drawee or payor after the mony has been taken out of the account of the drawer or maker and in the case of an agent collecting bank other

than the drawee or payor, which has received the proceeds in any form; and the owner of the item is entitled to preferential payment out of the assets of the failed trustee whether the proceeds can be traced and identified into a specific fund or not.

In case an item is received by a bank which fails before the actual payment or collection thereof, provision is made for return of the item where in its possession or that of the receiver. Furthermore, the provisions of Section 13 do not apply to items presented by mail which, at the election of the presenter, are treated as dishonored by non-payment according to the provisions of Section 11.

Sections 14 to 19 inclusive are self explanatory.

UNITED STATES CIRCUIT COURT OF APPEALS FOURTH CIRCUIT.

No. 3735.

W. H. Spradlin, Receiver of the Elkin National Bank,
Appellant,

versus

Royal Manufacturing Company, a corporation,
Appellee.

Appeal from the District Court of the United States
for the Middle District of North Carolina,
at Winston-Salem.

(Argued October 26, 1934. Decided November 19, 1934.)

Before Parker, Northcott and Soper, Circuit Judges.

John J. Ingle and John H. Folger for Appellant, and
E. C. Bivens for Appellee.

Parker, Circuit Judge:

This is an appeal from a decree holding a claim of the Royal Manufacturing Company for $3,483.73 to be a lien on the assets of the failed Elkin National Bank in hands of its receiver. The claim arose out of a draft on the Chatham

Manufacturing Company which was sent to the bank for collection. The company last named paid the draft by a check drawn against its deposit account with the bank, and the bank remitted for the collection by draft on one of its correspondents, but failed before this draft could be paid. There was, of course, no augmentation of the assets of the bank as a result of the collection, but merely a shifting of credits, and consequently no basis for the declaration of a trust. *Lifsey v. Goodyear Tire & Rubber Co.* (C. C. A. 4th) 67 Fed. (2d) 82, 83; *Ellerbe v. Studebaker Corporation of America* (C. C. A. 4th) 21 Fed. (2d) 993, 995; *Larabee Flour Mills v. First Nat. Bank* (C. C. A. 8th) 13 Fed. (2d) 330, 331. The learned judge below was of opinion, however, that the assets of the bank were subjected to a lien to the amount of the collection by reason of the proviso appearing in Section 218 (e) (14) of the North Carolina Code of 1927.

Section 218 (e) of the North Carolina Code is composed of twenty-three subsections all of which relate to the liquidation of state banks. Subsection 14 thereof, which contains the proviso in question, is as follows:

"(14) Declaration of Dividends; Order of Preference in Distribution.—At any time after the expiration of the date fixed by the Chief State Bank Examiner, or the duly appointed agent, for the presentation of claims against the bank, and from time to time thereafter, the Corporation Commission, out of the funds in its hands, after the payment of expenses and priorities, may declare and pay dividends to the depositors and other creditors of such bank in the order now or hereafter provided by law; and a dividend shall be declared when and as often as the funds on hand subject to the payment of dividends shall be sufficient to pay ten (10) per centum of all claims entitled to share in such dividends. In paying dividends and calculating the same, all disputed claims and deposits shall be taken into account but no dividend shall be paid upon such disputed claims and deposits until the same shall have been finally determined. The following shall be the order and preference in the distribution of the assets of any bank liquidated hereunder: (1) Taxes and fees due the Corporation Commission for examination or other services; (2) wages and salaries due officers and employees of the bank, for a period of not more than four months; (3) expenses of liquidation;

(4) certified checks and cashier's checks in the hands of a third party as a holder for value and amounts due on collections made and unremitted for or for which final actual payment has not been made by the bank; (5) amounts due creditors other than stockholders. The word 'asset' used herein shall not be deemed to include bailments or other property to which such bank has no title. Provided, that when any bank, or any officer, clerk, or agent thereof, receives by mail, express or otherwise, a check, bill of exchange, order to remit, note, or draft for collection, with request that remittance be made therefor, the charging of such item to the account of the drawer, acceptor, indorser, or maker thereof, or collecting any such item from any bank or other party, and failing to remit therefor, or the nonpayment of a check sent in payment therefor, shall create a lien in favor of the owner of such item on the assets of such bank making the collection, and shall attach from the date of the charge, entry or collection of any such funds. A statement of all dividends paid shall be filed in the office of the clerk of the Superior Court in the pending action, and said statements shall show the expenses deducted and the disputed claims and deposits considered in determining said dividend."

It is clear, we think, that even if this proviso be construed as having relation to solvent banks as distinguished from those in liquidation, it cannot affect national banks. It has been held that these banks have no power to pledge their assets to secure a private deposit (*Texas Pac. Ry. Co. v. Pottorff*, 291 U. S. 245, 253); and one of the reasons for this holding is that to permit such pledge would be inconsistent with many provisions of the national bank act which are designed to insure a ratable distribution of assets among creditors. The same reasoning would forbid the creation of a lien on assets as security for funds collected. And, of course, if the creation of such a lien be beyond the powers of the bank, it could not be created by act of the state legislature; for the legislature could not provide that action on the part of the bank should give rise to a lien which the bank, by reason of the limitations imposed upon it by act of Congress, was powerless to create.

But it is clear that the statute in question was not intended to have application to solvent banks. Quite apart from the fact that it is a proviso to one of the sub-sections of a statute dealing with the liquidation of insolvent banks,

it appears that it can have no practical application except in connection with their liquidation. The lien created, although it is to attach from the date of the charge, entry or collection, arises only upon "failing to remit" or "the non-payment of a check sent in payment"; and it is manifest that a solvent bank will not fail to remit collections or permit a check sent in payment of a collection to remain unpaid. It is only in case of banks which have failed, therefore, that the statute can have any practical application; and the lien which it creates is of such a character that it can be enforced only by a liquidation of the bank. See *Lewis v. Fidelity & Deposit Co.*, 292 U. S. 559 at 563 and 567. The statute must be construed, therefore, as relating to the distribution of assets in the hands of banks which have failed; for "in whatever language a statute may be framed, its purpose must be determined by its natural and reasonable effect." *Collins v. New Hampshire*, 171 U. S. 30, 34; *Morgan v. Louisiana*, 118 U. S. 455, 462; *Henderson et al. v. Mayor of New York*, 92 U. S. 259, 268. So construed, it can have no application to the assets of national banks; for the national banking act provides how the assets of insolvent national banks shall be distributed. 12 U. S. C. A. 194. And it is well settled that state statutes cannot affect this distribution. *Davis v. Elmira Savings Bank*, 161 U. S. 275; *Easton v. State of Iowa*, 188 U. S. 220; *Old Company's Lehigh v. Meeker* (C. C. A. 2d), 71 Fed. (2d) 280; *Fiman v. South Dakota* (C. C. A. 8th), 29 Fed. (2d) 776, 777; *First Nat. Bank of Chicago v. Selden* (C. C. A. 7th), 120 Fed. 212.

The case of *Lewis v. Fidelity & Deposit Co.*, 292 U. S. 559, relied upon by appellee, is in reality an authority against its position. In that case a statute of Georgia, creating a general lien on the assets of banks as security for deposits of state funds, was held to have application to a national bank merely because the act of Congress of June 25, 1930, c. 604, 46 Stat. 809, 12 U. S. C. A. 90, authorized a national bank to give security for a deposit of public funds of the same kind as authorized by state law for state banking institutions. The Supreme Court said that no lien under the Georgia statute arose in 1928 when the deposit was made, and that the judgment of the court below sustaining the lien would have been reversed but for the enactment by Congress of the Act of 1930. See p. 564. Here

there is no act of Congress authorizing the creation of a lien on the assets of a national bank as security for collections; and the act of the North Carolina legislature can no more create a lien on the assets of a national bank than could the Georgia statute without the aid of the act of 1930.

We do not interpret the proviso as having been intended to make the collecting bank the agent of the holder of the item sent for collection, which was the purpose of the sections of the uniform bank collection code under consideration in *National Bank of America v. U. S. F. & G. Co.* (C. C. A. 7th), 71 Fed. (2d) 618, 619, and *Old Company's Lehigh v. Meeker, supra.* Nevertheless, under the rule recognized in this Circuit, the bank here was the agent of the owner of the draft for the purpose of making the collection and remitting the proceeds. *Ellerbe v. Studebaker Corporation* (C. C. A. 4th), 21 Fed. (2d), 993, 994; *Lifsey v. Goodyear Tire & Rubber Co.* (C. C. A. 4th), 67 Fed. (2d) 82, 83. But under the authority of these cases, appellee is not entitled to have a trust declared or to receive preferential payment from the assets in the hands of the receiver, since it has failed to show that these assets have been augmented as a result of the collections.

For the reasons stated, the decree appealed from will be reversed.

Reversed.